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United States Senate
WASHINGTON, DC 20510-2002

May 6, 2004

CTO

Ms. Louise Roseman
Board of Governors of the Federal Reserve
Division of Reserve Bank Operations and Payment Systems
20th Street and Constitution Ave., NW
Washington, DC 20551

**Re: Significant Concerns about the Federal Reserve Board's Proposed
Check 21 Rule**

Dear Ms. Roseman,

I have deep concerns about the Federal Reserve Board's proposed rule to implement the Check 21 legislation. The proposed rule **fails to give** consumers the protections provided by **Congress in enacting Check 21**. Three major changes are essential if **this** rule is to serve the intent of Congress - to promote efficiency in the payment system without exposing consumers to new risks. First, **the** rule should be changed to give **consumers** the right of recredit in all disputes about the payment of a check that **is** processed in whole or in **part** as a substitute check, or that **was returned** to the consumer as a substitute check. Second, the rule should expressly confer on consumers a **right** to receive a substitute check, at no cost, upon request. Third, the rule should restrict the creation **of** substitute checks to financial institutions, to avoid confusion between the electronic conversion of a check by a non-bank and the creation of a substitute check under Check 21 **by** a non-bank.

The most significant deficiency in the proposed rule is that it fails to give consumers the key right of recredit in every instance where there is a dispute about a check **that was** either processed using a substitute check or returned to the **consumer as** a substitute check. The proposed rule restricts recredit only to **when** a substitute check "**was provided**" to a consumer. Proposed rule, section 229.54(a)(1). The weight of the language of the statute, and its purpose, do not support that restriction. Section 7(a) does state generally that a consumer may make a claim for expedited recredit if the consumer **asserts** in good faith that the bank charged **the** consumer's account for a substitute check that **was** provided to the consumer. However, the procedures for claims spelled out in Section 7(b) do not require any allegation that the consumer **was** provided with a substitute check. Section 7(c) requires that a bank "shall recredit" a consumer's account under described circumstances, **which** do not include that a substitute check **was** provided to the consumer. Instead, the statute requires that a bank recredit a **consumer's** account after **an** allegation that the check was improperly charged to the **consumer's** account or the consumer has a **warranty claim**, plus the other elements of a claim under Section 7(b), unless the bank both

provides the consumer with the original check or **an accurate** copy of the original check **and** also demonstrates to the consumer that the substitute check was properly charged to the consumer's account

The second significant deficiency in the proposed rule is its silence **on** the right of a consumer to receive a substitute check, **without** fee, on request. Check 21 is built **around** the implicit premise that a substitute check will be available to **a** consumer in lieu of **an** original check. The rule should be augmented to provide that a financial institution on which a check is drawn must provide **a** substitute check at no cost in response to a request for **an** original check, a request for a copy of the original check, or **a** request for a substitute check. The only exception to this obligation should be if **the** financial institution in fact provides the original check,

Thirdly, **I** am concerned about the potential for creating **new** consumer confusion if the proposed rule continues to permit substitute checks to **be created** outside the **banking** system. The proposed rule permits a non-financial institution check recipient, such **as** a merchant, to **create** a substitute check if the **bank** of **first** deposit takes responsibility for that check. Merchants already have **a** method to **transform** a check into **an** electronic payment. That method, sometimes called *ARC*, automated receivables clearing, is subject to Regulation E, which protects consumers in the event of **erroneous** or duplicate processing.

The three changes to the proposed rule described in **this** letter **are essential** to carry out **the** intent of Congress, and **the** promise made by the Fed to members of **Congress** that **Check 21** would protect consumers despite **the** replacement of original checks by substitute checks in check processing **and** check return.

Sincerely,



Senator Paul S. Sarbanes